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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

The Role Of Tourism In The Yugoslav Economy

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CENTRAL INTELLIGENCE AGENCY

Directorate of Intelligence

July 1971

INTELLIGENCE MEMORANDUM

THE ROLE OF TOURISM IN THE YUGOSLAV ECONOMY

Introduction

1. Ten years ago, Yugoslavia was earning \$14 million from fewer than one million foreign tourists. Today the take is \$248 million from five million visitors. As Yugoslav tourist officials have long known, a long coastline and mild weather make the country a natural for tourism. In the early 1960s, President Tito "officially" decided to push tourism to earn much needed foreign exchange. This is why 1970 was disturbing - tourist earnings rose by only 2.5%, breaking a string of annual increases that had not fallen below 17% since 1960 and had averaged over 30%. This memorandum will examine Yugoslavia's tourist boom and assess the recent problems and the potential of the industry in view of its vital role in the Yugoslav economy.

Conclusions

2. In 1970, Yugoslavia's tourist boom came to rest against a bottleneck in capacity, problems in financing new investment, and some unfavorable publicity from abroad. These problems made it impossible to reach the \$350 million earnings mark predicted for 1970 and cast doubt on the latest five-year forecast, which showed earnings of \$750 million in 1975. In view of the industry's problems, tourist earnings by 1975 will probably be closer to \$500 million, compared with \$248 million in 1970. And if the outflow of Yugoslav travelers continues to increase, net earnings probably will not exceed \$350 million by 1975.

3. The Yugoslavs cannot afford a prolonged slowdown in earnings from tourism. Net earnings have been covering about 20%-25% of

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Yugoslavia's chronic trade deficits in recent years. Not only have these receipts permitted more imports than exports could finance, but without them the government's efforts to liberalize the economy and open it to world trade would be hamstrung by the need for excessive import controls. Tourist earnings have bought time for Yugoslavia to upgrade its export potential by attracting foreign investment and developing more marketing know-how.

4. Beyond 1975, the outlook is brighter. The United Nations' Adriatic projects will begin yielding results by the end of the 1970s. In addition to benefiting the already developed Croatian coast, these projects involve winter activities, stretching Yugoslavia's tourist season from a summer-only proposition to a year-round event. These programs also will give a lift to one of Yugoslavia's most backward regions - Montenegro - which will take some of the sting out of charges that investment in tourism is biased exclusively toward the more developed republics.

5. In the meantime, the Yugoslavs will have to solve much more than capacity and investment problems. In addition to chronic inflationary pressure, there have been complaints abroad about unsafe air travel and bad hotel and restaurant service. Moreover, tourists have resisted the poor assortment of goods in the Yugoslav market. Taking care of these complaints will spell the difference between a one-time visitor and a permanent fan of Yugoslavia's tourist attractions.

Discussion

The Tourist Boom

6. Tourism has become the largest single item in world trade, growing at a rate in excess of 10% per year. For fortunate countries endowed with suitable topographic and climatic resources and a historical or cultural mystique, tourism has become a leading industry - absorbing higher employment and increased investment in private enterprise and the social infrastructure, and earning large amounts of foreign exchange. One Cinderella story is that of Spain, with receipts from tourism in 1969 of \$1.3 billion, or \$40 per capita. Another, on a smaller scale, is Yugoslavia, with receipts of \$242 million, or \$12 per capita in 1969. In the ten years after 1959, gross earnings increased nearly 18 times and Yugoslavia expanded its share of the European tourist market from insignificance in the 1950s to 3%.

7. In the early 1950s, Yugoslavia was as little interested in tourism as tourists seemed to be in coming to Yugoslavia. Domestically, the stress

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was on post-war reconstruction and the development of the industrial sector of the economy. Europe too was preoccupied with restoring the pre-war standard of living. It was not until 1954 that as many tourists arrived in Yugoslavia as in 1939.

8. By 1956 the Yugoslav tourist industry was beginning to recognize the market's potential. The industry benefited from increased investment in hotel and catering enterprises and in transportation facilities. By 1962, however, earnings from tourism had reached only \$32 million.

9. In 1962 the tourist industry received solid support from President Tito:

Up to now our industry has not provided much in the way of foreign exchange so to reduce our [trade] deficit. On the contrary, this deficit has become bigger and bigger every year, and we have neglected certain sectors in our social and economic life. This applies first of all to tourism. We have always looked upon tourism as something secondary, which was not important. We said: if someone wants to come, our Adriatic Sea is beautiful, let them come and when they see it, they will come back. That won't work anymore. We must take a different view of tourism and change our criteria ...

10. Yugoslavia always had offered beaches and sunshine at low price. Now Tito called for improved access routes, new hotels and restaurants, and "everything else that will bring foreigners to our sea." The speech sparked a boost in investment outlays from an average of \$9.5 million in 1959-61 to \$27.6 million in 1962-65. Advertising campaigns were mounted and new contacts for group tours were made with foreign travel agencies. Moreover, Tito's official backing cleared away some of the political uncertainty. Many Westerners undoubtedly would be intrigued by a trip to Communist Yugoslavia; now it was nice to know that they indeed were welcome.

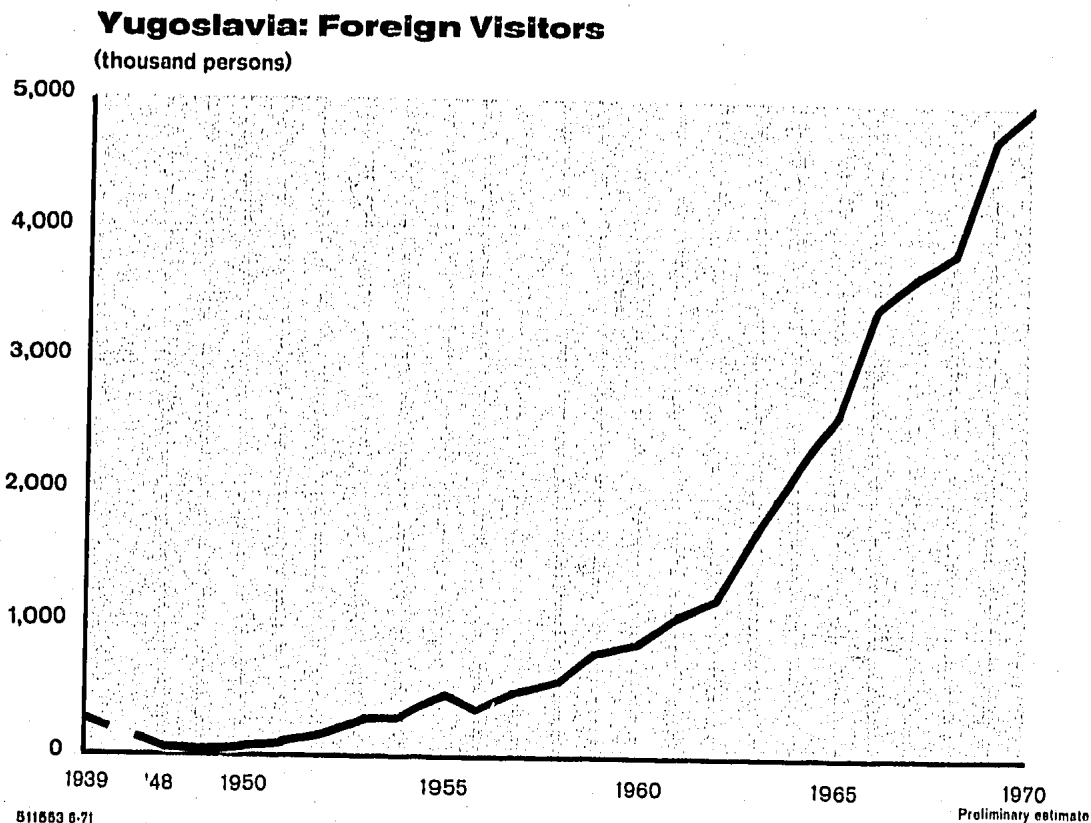
11. The tourists began coming -- the annual increase jumped from 100,000-200,000 during 1957-61 to 400,000-500,000 in 1963-65. By 1970, Yugoslavia was entertaining 5 million tourists -- a far cry from the 500,000 that were coming in the mid-1950s (see the chart).

Tourism and the Domestic Economy

12. The fact that tourism accounts for only 2% of Yugoslavia's social product and 3% of employment in 1969 greatly understates its role in the economy. The rapid growth of the industry has been a spur to employment

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and output in other sectors -- electric power, building materials, construction, transportation, agriculture, and handicrafts. And tourism has been one industry that had added little to Yugoslavia's import burden -- purchases of foreign equipment for the tourist industry, for example, have averaged less than \$1 million in recent years. Of course, like rapid expansion in any sector, the tourist boom probably has contributed to inflation by pressing on available supplies of building materials, agricultural products, and investment funds. For one thing, investment in tourism in 1969 was nearly 70% of its social product compared with an average share of less than one-quarter for the economy as a whole.

13. The distribution of foreign tourists and their spending has tended to reinforce regional economic inequalities in Yugoslavia. Almost 90% of

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foreign tourists in 1969 went to the more developed northern republics, nearly 60% to Croatia alone. Montenegro and Bosnia-Herzegovina accounted for almost all of the 10% of tourists that went to the less developed areas. There has been very little change in these shares in 10 years. With the exception of Montenegro, the less developed areas are shut off from the sea, away from the mainstream of tourism (see the map).



14. The policy of banks in granting investment credit has perpetuated the inequalities. In view of the scarcity of investment funds the banks followed a policy of risk minimization. Credit preference was given to large, reliable organizations. A minimum size of 1,000 beds was required, but

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the average capacity of firms receiving credit was over 3,000 beds. Since Croatia had the largest number of organizations of suitable size, the Croats naturally received most of the investment; in fact their share jumped from 44% in 1966 to 64% in 1969.

15. Not only has tourism contributed to the widening economic gulf between the have and have-not republics, but it also has been an added source of regional conflict. The Croats, as the leading tourist earners, want to retain foreign exchange earnings for use in their area. They argue that with the help of tourism they account for 38% of Yugoslavia's foreign exchange earnings but account for only 26% of imports. The less developed regions are generally in favor of the current system under which a large part of foreign exchange is surrendered to, and redistributed by, the national bank. They argue that without the foreign exchange they will fall further behind the developed regions.

Tourism and the Trade Balance

16. More crucial to the economy than the domestic role of tourism is its impact on the balance of payments. In this respect the growth of tourism has been essential. Yugoslavia couples a high propensity to import with a marginal export performance by industries very sensitive to world market fluctuations. The product has been a consistent series of annual trade deficits, resulting in an increasingly heavy debt burden, and a periodic need to appeal to foreign creditors for refinancing. The trade deficit reached a record \$1.2 billion in 1970.

17. There are three ways out: (1) permanent import controls, (2) a large inflow of direct foreign investment to reduce credit needs and provide export outlets, or (3) a rapid increase in invisible earnings. Import controls -- when they have been effective -- have seriously impeded the growth of the domestic product, and they are not in line with efforts to open the Yugoslav economy to world trade. Foreign investment is in line with this effort, but it has been slow in coming. In any case, the impact of foreign investment on exports will be felt only slowly.

18. The three largest components of Yugoslavia's invisible account are transportation, workers' remittances from abroad, and tourism. Although transportation earnings are considerable, they largely play a passive role, moving in line with, or behind, trade activity. From 1965 to 1969, for example, net transportation earnings rose by 37% while total trade increased

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50%. 1/ Workers' remittances have grown dramatically in recent years, by 129% from 1967 to 1969. Government efforts to encourage savings by Yugoslavs abroad had unexpected results in 1970 - workers' remittances more than doubled, reaching \$439 million compared with \$204 million in 1969. Unemployment at home has forced the government to tolerate and even encourage the outflow of workers. Now, with over 700,000 Yugoslavs employed abroad - more than 7% of the economically active population - a campaign has been started to induce workers to stay at home and return from abroad. Barring prolonged recession, the growth of remittances probably will begin to slow down in the next few years.

19. During the past 10 years, tourism has played the most consistent role in helping to offset Yugoslavia's craving for imports and in buying the time necessary to create solid export industries. As Tito puts it: "The foreign exchange which we earn through tourism is the cheapest foreign exchange from our standpoint, since we obtain this exchange without releasing any of our own resources to foreign countries; rather, in this way we sell those commodities which otherwise we would have to export at a discount." During the 1960s, the rate of growth of gross tourist receipts was nearly three times that of commodity trade turnover, and in 1969 these receipts represented a 16% addition to commodity exports. Net tourist earnings covered 25.6% of the trade deficit in 1969 compared with only 2%-3% in 1959-61. The progress of tourism in the Yugoslav foreign trade sector is reflected in Table 1.

20. An offset to tourist earnings has been the outflow of Yugoslav tourists to foreign countries - mainly to hard currency areas - rather than to the Adriatic coast. Expenditures on tourism in 1969 totaled \$74 million and decreased gross receipts by 30%. Outflows have been increasing faster than receipts since 1965, in spite of longstanding restrictions on the amount of dinars that can be taken out of the country and persistent efforts to promote domestic tourism.

21. One reason for the rising outflow is the rapid growth of foreign exchange accounts in Yugoslav banks. These accounts were authorized in the hope of attracting the deposit of earnings by workers employed abroad. Another source of foreign exchange in the hands of the population has been "private clearing" - that is, private sales of foreign exchange for dinars.

1. Earnings derived from the transportation of passengers by domestic carriers (transit) have been an additional source of foreign exchange. The growth of these earnings is induced by increased tourism, but has been slower than that of gross tourist receipts. Earnings can be expected to increase faster in the future because of recent massive investment in the transportation network.

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Table 1
Yugoslavia: Tourist Earnings and the Trade Balance

Year	Million US \$					Percent	
	Exports	Imports	Trade Balance	Gross Tourism	Net Tourism	Gross Tourism as a Share of Exports	Net Tourism as a Share of the Trade Deficit
1959	476.6	687.2	-210.6	12.8	6.6	2.7	3.1
1960	566.2	826.4	-260.2	14.3	7.0	2.5	2.7
1961	568.9	910.3	-341.4	20.0	8.0	3.5	2.3
1962	690.5	887.8	-197.3	32.0	23.0	4.6	11.7
1963	790.3	1,056.6	-266.3	53.0	44.0	6.7	16.5
1964	893.1	1,323.2	-430.1	69.0	56.0	7.7	13.0
1965	1,091.5	1,287.9	-196.4	81.0	63.0	7.4	32.1
1966	1,220.1	1,575.4	-355.3	117.0	72.0	9.6	20.3
1967	1,251.7	1,707.4	-455.7	150.0	98.0	12.0	21.5
1968	1,263.7	1,796.8	-533.1	187.7	136.6	14.9	25.6
1969	1,472.7	2,127.1	-654.4	241.5	167.8	16.4	25.6
1970	1,678.9	2,871.6	-1,192.7	247.6	N.A.	14.7	N.A.

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Although private clearing is illegal, enforcement is lax, and banks in their quest for foreign exchange do not ask the origin of funds deposited. Banks utilize these deposits, subject to a reserve requirement, as a basis for making domestic loans and to satisfy legal restrictions on the amount of foreign exchange they must possess in order to obtain credit abroad. Citizens use these deposits either for travel, circumventing exchange restrictions, or, perhaps, to engage in black market operations. The main compulsion for Yugoslavs to travel is to purchase goods that are in short supply domestically or of inferior quality - automobiles, washing machines, and refrigerators.

22. The only method of acquiring foreign exchange open to the citizen who remains at home is through private clearing. Although the black market rate for dollars is unknown, it can be assumed to approximate the rate at which enterprises exchange currency on the so called "gray market." Previous to the recent devaluation, dinars were exchanging for dollars on this market at a rate of 18 to 1, compared with the official exchange rate of 12.5 to 1. Given the disparity, individuals dealing with tourists made a quick profit by exchanging currency at a rate somewhere in between or by accepting foreign currency rather than dinars as payment for goods and services. The Yugoslav government has calculated that the leakage from official tourist receipts caused by private clearing equaled \$90 million in 1967 and \$98.3 million in 1968. Estimates for 1965-69 are shown in the accompanying tabulation.

	Million US \$				
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
Estimated private clearing	44.6	64.6	90.0	98.3	132.8
Adjusted net tourist receipts	107.6	136.6	188.0	234.9	300.6

23. The impact of tourism on the balance of payments is primarily important for Yugoslavia's hard currency trade. The hard currency deficit rose steadily from \$436 million in 1967 to \$574 million in 1969 and jumped to \$1.1 billion in 1970. Fortunately, the bulk of tourists come from the West and nearly all of these come from hard currency areas. As shown in Table 2, Western tourists accounted for 83% of the total number in 1969. Of these, 95% came from Western Europe and the United States. Estimated net earnings from Western tourists equaled \$145 million in 1969 which represents 25% of the hard currency trade deficit in that year.

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Table 2

Yugoslavia: Tourists, by Country

Source	Share of Total Tourists (Percent)		Average Length of Stay (Days)
	1959	1969	1969
Free World countries	94.4	82.6	4.70
Western Europe	84.8	75.2	5.07
West Germany	24.7	23.5	6.63
Italy	9.9	16.0	2.78
Austria	21.9	12.5	6.02
Benelux	5.1	5.8	5.00
France	7.7	5.7	3.41
Great Britain	7.9	4.7	4.86
Scandinavia	3.7	2.5	5.52
Switzerland	3.2	2.5	4.65
Other	0.7	2.0	3.17
United States	3.8	3.4	2.32
Other	5.8	4.0	2.44
Communist countries	5.6	17.4	4.86
Czechoslovakia	0.5	9.6	6.01
Hungary	0.6	2.6	2.93
USSR	0.5	1.6	2.74
Poland	1.6	1.3	4.27
East Germany	1.9	1.2	3.34
Romania	0.2	0.6	1.81
Bulgaria	0.3	0.5	2.07
<i>Total</i>	<i>100.0</i>	<i>100.0</i>	<i>4.72</i>

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24. The Western countries most important to Yugoslav tourism are West Germany, Italy, and Austria. In 1969 these countries accounted for 52% of all foreign tourists. West Germans do a lot of camping and many Austrians stay with relatives - both spend more time and less money per day in Yugoslavia than do the Italians. Since many Italians tend to visit Yugoslavia to purchase bargain goods, as well as to wine and dine at relatively expensive Slovenian resorts, their daily expenditures exceed the German-Austrian average by 30%.

25. Tourists from Great Britain and Scandinavia have both long stays and high daily expenditures. Although Great Britain's foreign exchange restrictions on travel have hurt all tourist countries, Yugoslavia has been able to reduce the impact by arranging low-cost package tours. Scandinavian tourists have been coveted but their numbers are small because of the travel distance involved.

26. Travelers from the United States stay the least and spend the most per day. Most Americans, however, confine themselves to central Europe or at best make Yugoslavia a one- or two-day stop on their way to Greece. Two- and three-week package tours covering both Greece and Yugoslavia have become increasingly popular with Americans and are a step forward even though Yugoslavia still gets the short end of the stay. Average daily expenditures of Western tourists from a 1967 survey of seaside resorts are summarized in the accompanying tabulation. (See Table 2 for length of stay in 1969.)

	<u>US \$</u>
Austria	6.48
West Germany	5.84
Italy	8.00
Great Britain	8.56
Scandinavia	9.04
United States	12.96

27. Tourists from Communist countries have played a small role in terms of earnings as well as numbers. In 1969, travelers from the USSR and other countries of the Council for Mutual Economic Assistance (CEMA) accounted for 17% of the number of tourists and 14% of earnings. The share of Communist tourists has risen since the early 1960s, when Yugoslav-CEMA relations thawed and travel restrictions were eased. Given the scarcity of permits to visit the West, Yugoslavia has been an optimal choice for Communists with the means to travel. They have found not only a low-cost recreational playground but also an opportunity to buy

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Western products which are hard to find at home. The Czechs -- accounting for 55% of all Communist tourists in 1969 -- have taken the most advantage of these attractions in the past. However, the influx of Czech visitors -- and with it the Communist share -- dropped by nearly 60% in 1970. As a result of the 1968 invasion of Czechoslovakia, approximately 30,000 Czechs failed to return from their holiday in Yugoslavia during 1969. As a result, the Czech government imposed foreign exchange restrictions on travelers to Yugoslavia. The decrease of Czech tourism was one of several reasons why 1970 was not so good a tourist year as it was expected to be.

The Problem Year -- 1970

28. Early estimates of the 1970 inflow of foreign exchange forecast earnings at \$350 million. It was to be another record year and would come very close to fulfilling the original five-year development plan target. This was not to be the case. In August, it was noted that the number of foreign tourists in July was 7% less than in 1969. Moreover, the total number of nights spent in 1970 through July was 3% lower than the corresponding period in 1969. Hope had been held out because earnings of foreign exchange by midsummer were estimated to be running 30% higher. But by the end of 1970, tourist earnings had gained only \$6.1 million -- 2.5% -- over 1969.

29. There was no single reason for the slowdown. In addition to the decrease in Czech visitors, the flow of Western travelers was impeded by a slowdown in European and US growth rates which caused consumers to defer expenditure on durable goods and other large outlays such as travel. Moreover, the German Auto Club mounted an advertising campaign critical of Yugoslav travel facilities. This was reinforced in the British press with articles about unsafe air travel.

30. Another factor was domestic economic instability. Average retail prices rose by 9% in 1970 but average prices of catering services increased by 16% and of food service alone by 22%. While failing to hold the price line, the government's deflationary monetary policies created a credit squeeze -- affecting tourism as well as other industries. The tourist industry, faced with rising building costs, was running out of rooms and the funds to finish backlogged construction in 1970.

31. The slowdown in tourist earnings in 1970 could not have come at a worse time -- the trade deficit and particularly the hard currency deficit were at all-time highs. The slowdown, however, has called attention to basic problems, often concealed by success in the past but crucial to the future of the Yugoslav tourist industry.

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32. Yugoslavia has a more than adequate supply of natural resources for tourism. Politics and nature have provided Yugoslavia with 2,092 km of Adriatic coastline. In addition, there are 30 islands in an area of 10 square kilometers or more, plus 730 smaller ones. One of the main impulses to the tourist boom has been the growing preference for a Mediterranean environment in contrast to the cultural attractions of inland Europe. In 1958 the West European share of international tourism was 38%; by 1967 it declined to 33%. Simultaneously the Mediterranean share increased from 19% to 24%. Yugoslavia's long coastline offers both climate and beaches comparable to the Mediterranean as well as a number of historical attractions.

33. A large part of the interior is mountainous and dotted with lakes, suitable for winter and aquatic sports as well as hunting, fishing, and hiking - a favorite pastime of German visitors. Moreover, there are over 300 mineral springs - many not yet developed -- to attract spa-conscious tourists, and for a lover of antiquity there are Greek, Roman, and Byzantine ruins.

34. Labor also is abundant. Even though much of the labor is unskilled, workers can quickly be trained for most duties in the hotel and catering industry. The quality of the training, however, is another matter. Judging from some complaints about service and worker attitudes toward tourists, some improvement needs to be made.

35. The major bottleneck to development, however, is lagging supply of accommodations. This is evidenced by the need to secure reservations far in advance of any seasonal visit, the high occupancy rate at hotels, and the continual encouragement given to the development of private lodging and catering services. Yugoslav data show that the better grade hotels are strained to above capacity in peak months. For example, luxury hotels on the Adriatic somehow had an occupancy rate of 121% in June 1969. Average peak occupancy rates in luxury and class A hotels in 1969 are shown below for sea and mountain resort areas.

	<u>Percent of Capacity</u>			
	<u>June</u>	<u>July</u>	<u>August</u>	<u>September</u>
Seaside	97	81	93	80
Mountain	57	77	83	82

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Another indication of inadequate hotel space is the large market for beds in private homes or guest houses. In fact, the rise of the share of privately offered beds indicates that the situation has worsened. As shown in Table 3, this share has risen consistently in the 1960s, reaching 40% in the last few years.

36. The capacity constraints can be traced to early neglect -- it was not until the early 1960s that tourism could compete on an equal footing with other sectors for available investment funds. Yugoslavia began the 1960s with only 212,665 beds for both domestic and foreign tourism. Moreover, less than 50,000 of these were found in installations with modern comforts. Yugoslav planners faced a massive need for facelifting as well as for new construction.

37. One of the main problems was the regional allocation of investment. At this time, most of the new construction and modernization was located in the larger tourist centers, with some funds also being channeled into the construction of tourist settlements such as camp-hotels with bungalows and other light lodging facilities. On the other hand, there were strong pressures to funnel funds into the less developed areas -- both because it would create new income and because it would aid in decreasing the seasonality of tourism by expanding the capacity for accommodation away from the crowded coast. However, the amount of investment necessary to establish resorts with as much earning power as those in operation on the coast would be proportionally greater. There would be no cost benefits, nor added growth dividends, in the interior regions from being able to expand upon an already established nucleus of tourist activities -- in short, no "agglomerating economies." For example, transportation can service many activities at less cost when they are near each other than when they are widely separated. Thus, on economic grounds, major investment on the non-Adriatic area was resisted as a less than optimal allocation of resources. Tito had said as much in 1962 when he stressed tourism on the seacoast.

38. The only significant redistribution of investment in the first half of the 1960s was an increase in funds for the smaller tourist locations along the Adriatic. This move was successful; the number of tourist places recording over 20,000 nights spent by foreign tourists increased from 21 in 1957 to 41 in 1961. Much of this increase can be attributed to the construction of new, modern roads enabling tourists to visit little known but attractive locations. This policy could have been even more successful if greater provision had been made in these areas for catering and for servicing automobiles.

39. By the mid-1960s, however, there were signs that the construction of new facilities and the reconstruction of existing ones had not matched demand. From 1962 to 1966 the number of foreign visitor nights had tripled

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Table 3
Yugoslavia: Capacity for Accommodation

<u>Year</u>	<u>Total Stock of Beds</u>	<u>Net Change Over Previous Year</u>	<u>Stock of Privately Offered Beds</u>	<u>Net Change Over Previous Year</u>	<u>Stock of Pri- vately Offered Beds as Percent of Total Stock</u>
1959	212,665	--	57,508	--	27
1960	254,095	41,430	82,591	25,083	33
1961	274,715	20,620	82,997	406	30
1962	292,723	18,008	87,944	4,947	30
1963	303,192	10,469	100,915	12,971	33
1964	354,711	51,519	125,491	24,576	35
1965	385,409	30,698	144,609	19,118	38
1966	399,080	13,671	156,902	12,293	39
1967	432,797	33,717	176,032	19,130	41
1968	454,096	21,299	182,395	6,363	40
1969	497,444	43,348	200,701	18,306	40

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and many tourists were forced to choose secondary types of accommodations - the percentage usage of hotels and "pensions" dropped from 59.3% in 1962 to 48.0% in 1966.

40. Obviously impressed by the sudden wave of tourists, the government raised its sights in the mid-1960s. The plan for 1966-70 projected an income from tourism amounting to \$400 million in 1970. This figure - 27% more than was collected during the entire 1955-65 period - hinged on plans to provide 90,000 to 100,000 new hotel and motel beds, 80,000 to 90,000 beds in private rooms, and 50,000 to 60,000 accommodation spaces in camps. Planned investment in hotels and catering was \$370 million, of which \$61 million was in foreign loans, \$53 million from hotel and restaurant organizations, \$123 million from banks and economic organizations, \$52 million from citizens, and \$44 million from internal credits. This, of course, did not include investment for the development of the necessary infrastructure, nor was any allowance made for inflation, which by now was a permanent fixture in the economy.

Investment Problems

41. Actual investment during 1966-70 greatly exceeded the plan, reaching about \$460 million (see Table 4). Still, less than one-half the planned number of beds were constructed by 1970. This is not surprising; the average cost of the construction of a hotel bed had increased from \$2,800 in 1966 to \$4,640 in 1970. Using the average of these two figures \$3,720 - the construction of 100,000 beds would have taken the entire amount of investment planned for 1966-70. Besides, if data for 1967 are typical, less than one-third of investment actually went into new construction during the period.

42. To achieve the construction plan, substantial foreign assistance would have been needed. An interview with Jozse Brilej, Chairman of the Federal Committee for Tourism, in January 1966, revealed that \$500 million in credit had been offered, but the country was heavily in debt, and not in a position to accept. A chief obstacle was the terms of the loans - 8 to 12 years at interest rates averaging 8%. By comparison, credit terms received by other tourist countries were for 15-25 years at interest rates ranging from 3% to 5%. Yugoslav agencies and enterprises desiring development loans wanted even more favorable terms - 15 years at 2%.

43. By 1967-68, officials realized that planned earnings of \$400 million would not be achieved and lowered the figure to \$350 million. It was also realized that achievement of the lower figure would depend on foreign credits earlier spurned. The solution was to have the banks instead of tourist organizations borrow from abroad and lend to the tourist industry.

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Table 4

Yugoslavia: Investment in the Hotel
and Catering Industry and Travel Agencies
by Source of Finance

Source	Million US \$					
	1965	1966	1967	1968	1969	1970
Hotel and catering enterprises	8.9	13.7	15.4	14.1	18.6	N.A.
Other organizations	0.2	1.1	0.2	0.6	0.9	N.A.
Banks	18.1	19.0	56.6	58.5	117.5	N.A.
Social-political communities	1.2	0.9	6.2	4.9	2.6	N.A.
Total	28.4	34.7	78.4	78.1	139.6	130.0 a/

a. Estimated.

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And since the latter could not borrow under terms which would enable banks to repay foreign sources, the government intervened and subsidized the difference in the rates of interest. In effect, about 70% of the total bank loans for tourism during 1966-70 came from foreign sources.

44. The government, however, failed to meet its obligation to the banks. Only \$15 million was paid out of a total of \$138 million in interest owed to the banks. The shortage of funds in many cases caused builders to halt further construction. After a lively debate a bill was passed in December 1970 to eliminate the subsidized rate of interest for investment in tourism. In order to ease the impact on building in progress a provision was negotiated enabling banks granting credits to raise loans abroad without losing their credit-granting potential or having to make foreign exchange deposits. Unfortunately, the banks found themselves in a position where they were unable to incur further foreign debts. Moreover, the increased cost of construction created an additional problem and the banks had exhausted all possibilities for covering the increased expenses.

Transportation - a Brighter Spot

45. Improved transportation has been crucial in increasing tourism (mainly road, sea, and air transport - foreign tourists make little use of the railroads). Better transportation facilities have lowered the cost of supply and have expanded demand by increasing the market area. The expansion of the highway system has contributed the most in the transportation sector to the development of tourism. The completion of the Adriatic highway has been very significant in the development of the main coastal attractions of Croatia, while the completion of other highways meant easier access to resorts and spas in other republics. The overall building program was underwritten by the World Bank and, besides highways, included the construction of a net of service stations and auto-camps for use by the 80% of the tourists who arrive by privately owned automobiles. The growing importance of the mobile tourist can be seen in Table 5.

46. Improvements in sea traffic have contributed to the growth of tourism by opening up coastal islands to foreign visitors, a good example is the hydrofoil service between Split and the Dalmatian Islands. Also, improved sea travel has increased excursions from the Italian ports to the Yugoslav tourist areas.

47. The increase in the number of airlines and flights serving Yugoslavia has expanded its market area to tourists from Scandinavia, Great Britain, and North America. Airports designed to increase the inflow of tourists have been or are being constructed near every major population and tourist center. Although described as "modern," the airports cannot

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Table 5

**Yugoslavia: Number of Entries
of Foreign Motor Vehicles**

<u>Year</u>	<u>Private Automobiles</u>	<u>Year</u>	<u>Private Automobiles</u>
1953	14,337	1962	662,544
1954	27,371	1963	967,415
1955	48,000	1964	1,677,721
1956	81,686	1965	3,569,830
1957	165,404	1966	7,963,202
1958	246,278	1967	10,156,107
1959	336,756	1968	10,490,913
1960	400,675	1969	12,024,325
1961	479,982	1970	11,900,000

handle the new jumbo jets, but they are adequate for the "bread and butter" charter craft. With the installation of these new facilities, air traffic has increased at a high rate. In 1968, Yugoslav airports handled 1,116,000 passengers and 1,572,000 in 1969. Preliminary estimates for 1970 are 2,248,000 passengers, or 43% above 1969.

Prices

48. A major explanation for the increase in Yugoslav tourism has been its low cost. For this reason the preponderance of tourists have been in the middle and lower income brackets, although even the more affluent have tended to substitute Yugoslavia for the more expensive tourist areas, or to choose it for a second vacation. Like improved transport, the lower prices have helped to expand the market area. In 1969 the average tourist spent \$6.40 per day for food and lodgings. Hotel guests spent more (\$9.68 per day) than those staying in tourist colonies (\$7.76 per day). However, many tourists preferred to stay in cheaper private lodgings or in camps where they got by with an average of \$5.52 and \$3.84 per day, respectively.

49. Yugoslav efforts to maintain competitive tourist prices have been periodically challenged by a persistent inflation. Price indexes for tourist services are given in Table 6. To counter increased prices and growing trade deficits, Yugoslavia has undertaken three devaluations in the past 10 years, in 1961, 1965, and 1971. Tourist industry officials have generally supported

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Table 6
Yugoslavia: Price Indexes

	1968 = 100									
	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
Cost of living	38	41	46	48	54	72	89	95	100	108
Retail prices	43	47	50	52	57	73	90	96	100	107
Producer prices	69	72	72	72	76	88	98	100	100	103
Elements and materials for building	64	70	69	70	73	83	94	97	100	105
Catering service (general index)	24	33	38	41	49	64	83	96	100	107
Food	24	31	35	39	50	68	85	97	100	108
Quarters	20	32	37	36	40	55	74	91	100	106
Culture and entertainment	34	41	43	44	45	64	80	91	100	106

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proposals for devaluation. Theoretically a decrease in relative prices results in an absolute increase in tourist receipts. 2/ Because of stiff competition from abroad and the supply constraints, industry officials believe that the main effect of devaluation has been just to retain their share of the tourist market.

50. Although these devaluations have not been undertaken primarily for the sake of the tourist industry, the net effect has been to neutralize the impact of inflation on tourist spending. In 1965 the devaluation increased the purchasing power of foreign currency 66.7% while prices rose only 35%-40%. The 1971 devaluation of 20% washed out much of a recent 10%-30% rise in hotel rates, helping to maintain the industry's competitive position in the current tourist season. Taking account of devaluation and inflation, the accompanying tabulation shows the average daily expenditure of tourists in 1968 prices.

<u>Year</u>	<u>US \$</u>	<u>Year</u>	<u>US \$</u>
1961	8.04	1966	9.58
1962	9.59	1967	9.70
1963	10.14	1968	10.91
1964	8.38	1969	10.06
1965	11.27	1970	8.85

51. Competitive prices, however, have not enticed tourists to spend as much as they do in other countries. An early move to change tourist spending patterns occurred in 1963 when 20% discounts were authorized on all Yugoslav industrial products except tobacco, food products, and gasoline. The discount only applied to purchases made in hard currency at shops designated by the National Bank to perform this service. After the 20% discount rate was in effect, sales increased from a turnover of approximately \$600,000 in 1963 to \$1,800,000 in 1964. Yet, spending on goods and services excluding hotels and food still accounted only for 8% of the foreign exchange earnings in 1964 compared with 25% in the more developed tourist countries. As the economy worsened in 1965, the 20% discount was unofficially extended to include all shops and even peddlers. These steps tended to insulate the tourist from Yugoslavia's persistent inflation, but the main problem is that the tourist cannot find much that he wants to buy.

2. It has been argued that the demand for tourism is elastic, unlike other invisibles, because of the operation of a large substitution effect. Hence, a relative price decrease in Yugoslavia would in the absence of other factors yield an increase in total receipts.

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52. Yugoslav tourism always stands to be affected by external uncertainties -- the most important being the weather and the world political climate. The effect of bad weather is obvious on a seasonally dependent industry. But the Yugoslavs have been lucky in this respect; their worst weather typically occurs in early spring and late fall -- hitting the crops but missing most of the tourists. Political uncertainty, however, has had much more of an impact.

53. In 1965, deteriorating West German-Yugoslav relations gave rise to a fear of manufactured incidents and the West German (and Austrian) tourist flow -- the backbone of Yugoslavia's tourist market -- decreased. In the summer of 1967, the Middle East crisis -- and Yugoslavia's pro-Arab stance -- caused a rash of cancellations by prospective visitors. The increase in tourists from most Western countries dropped off sharply in 1967 -- rooms could actually be obtained at prominent Adriatic hotels without a reservation. The slowdown was reinforced by a decline of 70% in southbound transit traffic. The Czech crisis followed in the summer of 1968. Yugoslavia's anti-Soviet stance provoked some tour cancellations -- notably from Bulgaria and the USSR -- and the crisis probably deterred some late summer trips by Westerners as well. Except for Czech travel restrictions, however, the effects on earnings were not lasting.

54. Having little control over external politics, the Yugoslav government has tried to remove other political barriers to tourism. Laws have been passed allowing foreign nationals to own houses and apartments, and granting amnesty to emigrants to enable them to return on visits. The number of frontier crossings and the number of ports have been steadily increased. Passport formalities were liberalized in 1961 by bilateral arrangements with many countries to abolish visas. In 1963, customs declaration forms were abolished. In 1967, designated by the United Nations as the International Tourist Year, Yugoslavia unilaterally suspended entry visas for tourists of all countries. In 1969, visas were reinstated for nationals of the few countries (the United States included) which had not reciprocated. In addition to these measures, the government has strictly instructed its security police not to interfere with the movement of tourists unless absolutely necessary.

The Future of Yugoslav Tourism

55. The preliminary 1971-75 plan for tourism is more ambitious than its predecessor. In the spring of 1970 the planners believed it was possible to achieve tourist earnings of \$900 million in 1975, supported by a planned investment of \$624 million. This represented increases of 125% in planned

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earnings and 70% in investment over the 1966-70 plan. But compared with actual results in 1970, earnings would have to increase by an awesome 260% in just five years, backed by only a one-third increase in investment over that in 1966-70. After the mediocre results in 1970, the Yugoslavs apparently lowered their goal - a figure of \$750 million in 1975 was supplied to the Organization for Economic Cooperation and Development (OECD) for their November 1970 survey of the Yugoslav economy. Also, a higher investment figure of \$696 million has been mentioned.

56. These figures still are highly optimistic. Unless there were dramatic increases in tourist spending, length of stay, or off-season visitors, the Yugoslavs would have to increase accommodations at an unprecedented pace. Even assuming (unrealistically) that spending per tourist doubled in the next five years to \$100 per visitor (almost twice the increase during 1966-70), the planners would be talking about 7.5 million tourists in 1975 - an increase of 2.5 million compared with 1.6 million during the 1966-70 period. And even if the tourist-to-bed ratio rose by twice the increase during this period (to 12 to 1 in 1975, compared with 10 to 1 in 1969 and 9 to 1 in 1966), the tourist industry would have to provide over 200,000 new beds, or 40,000 a year compared with an average of about 30,000 during 1966-70. Moreover, if 60% of these were non-private as currently, it would take nearly \$600 million at 1970 costs to provide these accommodations, let alone restaurants and other facilities.

57. As it is, Yugoslavia is still plagued with investment problems. Price instability and lack of investment credit have continued into 1971. From 15,000 to 20,000 new beds were planned for completion in time for the 1971 tourist season, but higher costs and credit problems continue to slow construction. Although the situation is viewed with alarm, Yugoslav banks - the major source of funds - can see little way of helping. In a figurative washing of hands, representatives of 12 banks met at Split in February to discuss the problem and decided that "because of outstanding and unsolved questions concerning the destiny of the present encouraging measures for financing investments in tourism, banks will no longer be able to participate in financing the building of hotels and other projects intended for foreign tourists."

58. Other sources of investment are not doing much better. Workers' remittances, slated for 25% of the total, would have to rise substantially; instead they probably will begin to level off during the next five years. Foreign credits, counted on for 17%, still are available in most cases only on premium terms. Thus, even if tourist organizations come up with their share, construction schedules will not be met. At best, 30,000-40,000 new hotel beds are likely to be completed by 1975, putting a continuing burden on private accommodations.

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59. Although gross receipts by 1975 may be more on the order of \$500 million than \$750 million -- tourism will continue to play a crucial role. It will have to. The outflow of tourists should continue at least at the same rate during 1971-75, so net receipts might reach perhaps \$350 million in 1975. Since trade deficits are as likely to fluctuate as wildly in the future as they have in the past, it is difficult to estimate the degree of coverage that tourism could provide. If imports and exports continue to increase at the average rate of the past 10 years, only about 15% of the deficit would be covered by net tourism in 1975. If either foreign or domestic events should prevent even a moderate growth in tourism, Yugoslavia could easily fall into a serious refinancing trap in the next few years.

60. The longer run outlook is better. In 1974, a 5,000-bed complex is to begin operating at Babin Kuk, near Dubrovnik, on the Adriatic coast. Babin Kuk ("grandmother's haunches") will cost \$50 million. The World Bank is supplying a \$20 million loan and Yugoslav banking and trading organizations are to provide the other \$30 million. Estimated earnings for the first year of operation are \$20 million based on full occupancy during 60% of the year.

61. Over the next 20 years, tourism will benefit greatly from the Northern and Southern Adriatic projects. Sponsored by the United Nations and partly financed by the World Bank, the \$1 billion program will not only provide tourist facilities on the coast, but winter sports areas as well. It will also be a stimulus to at least one less developed area -- Montenegro. When the first operations begin in the late 1970s, tourism will be well on its way to becoming the leading industry in Montenegro's backward economy.

62. To get the most out of these projects, and tourism in general, the Yugoslavs will have to make greater efforts in areas other than physical accommodations. Improved service and higher quality domestic goods at bargain prices, for example, will help prolong the stay and increase the daily expenditure of foreign visitors. New tourists will keep coming; it is up to the Yugoslavs to keep them coming back.

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